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FARM CREDIT ADMINISTRATION
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SUMMARY OF CASES RELATING TO FARMERS' COOPERATIVE ASSOCIATIONS

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REVOLVING FUND CERTIFICATES

The term "revolving fund certificate" does not have a precise and definite meaning. It is a coined term that is quite widely used in cooperative circles to describe a piece of paper that evidences a given amount of money which is to be paid to the holder on a date that may or may not be fixed.

A revolving fund certificate could be sold to anyone who is willing to pay the price therefor at the time of the organization of a cooperative association or at any time thereafter. Usually, however, such certificates are issued to the patrons of a cooperative to evidence patronage refunds arising from their business in a given year. In other words, a cooperative association, instead of paying patronage refunds in cash as of the close of a particular fiscal year and with respect to its business for that fiscal year, may issue some form of certificate with the intention of retiring these certificates in a later year. Amounts of money that are used for capital are thus accumulated, and when a sufficient amount has been accumulated to meet the financial needs of the cooperative, it begins retiring certificates issued in earlier years with patronage refunds that were made in subsequent years. For instance, a cooperative might, for say five years, defer the payment of patronage refunds in cash and pay patronage refunds in revolving fund certificates, and the sixth year it would use the money represented by the revolving certificates issued that year to retire the revolving fund certificates issued the first year, and this procedure would be followed indefinitely. The capital, or a substantial part of the capital, of a cooperative may thus be revolved. It is believed that the revolving fund plan constitutes one of the fairest and most equitable ways of capitalizing a cooperative association. (See <u>Bowles</u> v. <u>Inland Empire Dairy Association</u>, 53 F. Supp. 211; Legal Phases of Cooperative Associations, page 276.)

Producers when they form a cooperative association are going into business to do for themselves things that heretofore have been done by others. It takes money to go into business. There is a constant turnover in the membership of a cooperative association due to death, and the fact that farmers retire from farming. It is only just that new members and patrons of a cooperative association should furnish capital for the cooperative because they get the advantage of its services, and it is only just that the patronage refunds arising from their business should be used for retiring the revolving fund certificates issued in previous years to the members who patronized the association in those years. The original charter members of associations should not be expected to pay for the physical facilities of an association and then pass them on to later members "free of cost." This penalizes the pioneers, the ones who bore the risks incident to the starting of a new business enterprise. The revolving fund plan of financing goes far toward assuring that the patrons of a cooperative will eventually have returned to them capital that they have furnished to the cooperative. This, of course, might be after they had ceased to be members.

The terms and conditions of so-called revolving fund certificates may differ considerably. In some cases, revolving fund certificates may be certificates of indebtedness with a specific due date. In instances of this character, a patron of a cooperative receives an obligation which the cooperative is required to pay on the date named in the certificate. From a practical standpoint, such certificates of indebtedness are little different from an ordinary promissory note, and obviously a suit may be brought on them if not paid at maturity. Of course, certificates of indebtedness may be used as a part of a plan for revolving the "capital" of a cooperative association. From a technical standpoint, the amounts evidenced by certificates of indebtedness represent indebtedness and not capital. As a rule, certificates of indebtedness and other forms of revolving fund certificates are made junior to other claims against the cooperative, and this operates to cause the amounts in question to have the status of capital so far as third persons are concerned. (See Commissioner of Internal Revenue v. National Grange Mutual Liability Company, 80 F. 2d 316.) In fact, certificates bearing various names, such as certificates of equity or certificates of interest, are used by cooperative associations as a part of plans for revolving the capital of their associations. Some associations issue certificates of stock, usually preferred stock, for accomplishing the same purpose. Indeed, some associations simply give their patrons "credit" on their books. In a case in which a cooperative association issues certificates of indebtedness with a specific due date, it is clear that the obligations constitute debts of the association.

In order for a nonexempt cooperative to be in a position to deduct patronage refunds which it pays, it must be under a mandatory obligation to make such patronage refunds at the time the business in question was transacted. And being a mandatory obligation, it is one with respect to which the board of directors has no discretion, except possibly with respect to the way in which the patronage refunds will be paid, namely, in cash or otherwise.

It is clear that if patronage refunds, in pursuance of a mandatory obligation, are paid in cash or in a form of certificate that has a due date and thus clearly constitutes a debt, the amounts in question may be excluded in computing the income taxes of the cooperative association in question. In Peoples Gin Company, Inc. v. Commissioner of Internal Revenue, 118 F. 2d 72, Summary No. 12, page 1, the court said:

> "When this income was received by the corporation there was no obligation to make refunds or rebates to stockholders. The profits from ginnings for stockholders, therefore, became a part of the gross income of the taxpayer, and the character of this income for tax purposes was not changed by the adoption of subsequent resolutions and by-laws." (Underscoring added.)

(See also American Box Shook Export Association v. Commissioner of Internal Revenue, 156 F. 2d 629; Summary No. 31, page 7; Greene County Farmers Sales Association v. United States, 55 F. Supp. 123; Summary No. 23, page 6; Uniform Printing and Supply Company v. Commissioner of

Internal Revenue, 88 F. 2d 75; Home Builders Shipping Association, 8 B.T.A. 903; Anamosa Farmers Creamery Co., 13 B.T.A. 907; Farmers Union Cooperative Association, 13 B.T.A. 969.)

In the case of In Re General Film Corporation, 274 F. 903; Summary No. 34, page 1, it was held that amounts the corporation was obligated in advance to refund to its patrons on a patronage basis constituted expenses and were therefore deductible in determining the income taxes of the corporation.

There is a basic difference between a deduction and an exclusion. Amounts that may be excluded in computing income taxes are amounts that were not income at any time. Income taxes may be required to be paid only on income, and if a given amount of money is not income, no income taxes may be required to be paid thereon. The Supreme Court of the United States held in Commissioner of Internal Revenue v. Wilcox, 327 U.S. 404, that any amount a taxpayer is obligated to return does not constitute income and hence no income taxes may be required to be paid on account thereof. In that case, the court said:

> "For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain." (Underscoring added.)

(See also McKnight v. Commissioner of Internal Revenue, 127 F. 2d 572.) Likewise, amounts that are furnished and received as capital may be excluded as they are not income and therefore no income taxes are required to be paid thereon. Indeed, amounts that are excludable should not have been included at all in the gross income of the taxpayer. If they had not been included, there would have been no occasion for excluding them. The right to make a lawful exclusion in computing income taxes is not dependent on statutory authority.

On the other hand, it should be remembered that the only deductions which may be made by any corporation in computing its income taxes are those specified by Congress. A deduction is an amount of money that is income but which Congress permits to be taken out in computing income taxes. The making of deductions in computing income taxes is entirely a matter of legislative grace (White v. United States, 305 U.S. 281) and not of right, and only to the extent that Congress has provided for making deductions may any deductions be made.

Many cooperative leaders believe it is unwise to issue any form of revolving fund certificate that has a due date because it constitutes a liability, and the association may, through no fault of its own, not be in a position to retire the certificates when they fall due. They argue that it is better financing to permit certificates to be retired only at the discretion of the board of directors of the cooperative.

When certificates may be retired only at the discretion of the board of directors of an association, they obviously do not have a due date.

Technically it may be said that they do not represent debts. In 26 C.J.S., on page 4, it is said:

> "Every debt must be either solvendum in praesenti, or solvendum in futuro - must be certainly, and in all events, payable; whenever it is uncertain whether anything will ever be demandable by virtue of the contract, it cannot be called a 'debt,' since debt is a liquidated demand, the payment of which is not dependent on the happening of any contingency or the performance of any condition."

Therefore, amounts represented by revolving fund certificates or otherwise that do not have a due date and which are payable only at the discretion of the board of directors of a cooperative do not represent debts. Hence, if the amounts in question were not furnished and received as capital, it is open to question if they could be excluded in computing the income taxes of an organization on the theory that they do not constitute income. Likewise, it could not be said that they constitute debts or expenses within the meaning of 26 U.S.C. 23.

The Internal Revenue Code contains no provisions specifically authorizing the deduction of patronage refunds, or dividends as they are sometimes called. Section 23 of 26 U.S.C. gives all the deductions Congress has authorized taxpayers to take, and this section does not contain any language which deals specifically with patronage refunds.

It is true section 23, in paragraph (a) (1), authorizes the taxpayer to deduct "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered." Of course, it may be said that patronage refunds which an association is under an obligation to make constitute an expense, and hence that a cooperative is entitled to deduct such patronage refunds. Attention, however, is called to the fact that this theory would require that a cooperative be under a mandatory obligation to make such refunds at the time the business in question was transacted. On the other hand, as previously pointed out, amounts which any taxpayer is obligated to return do not constitute taxable income, and hence may be excluded in computing the net taxable income. In other words, no statutory authority is required to permit a taxpayer to deduct amounts that he is obligated to return. Again, since money that is furnished and received as capital is not income, it may without statutory authority be excluded in determining the net taxable income of a taxpayer.

It is believed that a cooperative is on sounder ground in having the amounts that are evidenced by revolving fund certificates furnished and received as capital under its organization papers. In the case of <u>Appeal of Paducah & Illinois Railroad Company</u>, 2 B.T.A. 1001; Summary No. 30, page 1, a bridge cooperative that was owned and operated by three railroad companies received rates, tolls, and charges for the use of the bridge. The part of such rates, tolls, and charges over and above its operating and maintenance costs and expenses was held by the Board of Tax Appeals, now the Tax Court of the United States, to be capital. Because these

excess amounts under the terms of the organization papers of the bridge company were held to be capital, no income taxes were required to be paid on them. A similar conclusion was reached in United Cooperatives, Inc. v. Commissioner of Internal Revenue, 4 T.C. 93; Summary No. 24, page 1. In each of these cases, the cooperative involved was required to issue certificates of stock on a patronage basis for all amounts over operating and maintenance costs and expenses. (See in this connection Decatur Water Supply Company v. Commissioner of Internal Revenue, 88 F. 2d 341.)

It would appear that the issuance of certificates of stock is not essential to establishing that such excess amounts are capital and that any form of certificate, or even credits on the books of the cooperative, would be sufficient. In United States v. Pickwick Electric Membership Corporation, 158 F. 2d 272; Summary No. 33, page 17, amounts paid by members of the cooperative to meet amortization charges on indebtedness on its physical facilities, and which were simply credited on its books, were held to be capital and not income.

In the case of an association that is using a marketing contract, the members may specify in the marketing contract the amount of capital that may be retained by the association. Of course, such deductions should be furnished, received, and accounted for in all respects as capital. Such deductions for capital could be made in lieu of deductions for reserves. In this connection it will be recalled that it is not unusual for the stockholders of a corporation to pay money to the corporation on the basis of their stockholdings for the purpose of enabling the corporation to have a paid-in surplus. Amounts so paid in have the status of capital and are so regarded by the Bureau of Internal Revenue. (See section 29.22(a)-16 of Regulations 111 issued by the Bureau of Internal Revenue.)

If the good will of a corporation is damaged, and thus the capital of the corporation is reduced, the recovery by the corporation from the wrongdoer of the amount of the damage done to its good will is simply a restoration of capital and does not constitute taxable income. (Raytheon Production Corporation v. Commissioner of Internal Revenue, 144 F. 2d 110; see also Decatur Water Supply Company v. Commissioner of Internal Revenue, 88 F. 2d 341.)

In the case of San Joaquin Valley Poultry Producers' Association v. Commissioner of Internal Revenue, 136 F. 2d 382; Summary No. 19, page 9, the Court held that certain reserves which the association accumulated and which were prorated as required by its bylaws and credited on its books to its members were in view of its organization papers and the statute under which it was organized the property of its members, and hence were not taxable in its hands. The Court said:

> "The fact that the sums were not payable to the members on demand, or at any fixed time, does not alter the fact that they were their property and not petitioner's. Petitioner held them, not as owner, but as agent or trustee for the members."

Under the ruling in the foregoing case, in any instance in which it appears from the organization papers and the statute under which an association is incorporated that amounts carried to reserves are the property of the members, such reserves would not constitute income in the hands of the cooperative.

Apparently the reason that the Tax Court of the United States refused in Fountain City Cooperative Creamery Association v. Commissioner of Internal Revenue, 9 T.C. 1077; Summary No. 37, page 1, to permit patrons' equity reserves to be deducted in computing the income taxes of the nonexempt cooperative was because the reserves were held under conditions that would not result in their being debts, and no claim was made that the amounts in question were received as capital. In Midland Cooperative Wholesale v. Commissioner of Internal Revenue, 44 B.T.A. 824, it was held that certain sums that had been carried to reserves were deductible because it was found that they were payable on demand, which, of course, meant that they were debts.

Excluding instances like the San Joaquin case, is a nonexempt cooperative association entitled to deduct or exclude any patronage refunds or dividends whether represented by certificates or paid in cash that do not have the technical status of debts, assuming that such patronage refunds do not represent money that was furnished and received as capital?

COOPERATIVE REQUIRED TO PAY GROSS INCOME TAXES

The case of Diekmann v. Evansville Producers Commission Association, decided by the Supreme Court of Indiana, 40 N.E. 2d 327, involved the question of whether the association was exempt from the gross income tax of the State of Indiana.

The association was organized under the Cooperative Marketing Act of Kentucky, and qualified as a foreign corporation to do business in Indiana. The association in the trial court enjoined the sheriff of Vanderburgh County and others from collecting gross income taxes from the association for the years 1933, 1934, and 1935. An appeal was then taken:

> "The question is whether appellee's business falls within the exception of § 7(b), Ch. 50, Acts of 1933, at p. 393, reading:
>
> 'Sec. 7. There are, however, excepted from the provisions of this act: * * *
>
> '(b) Labor, agricultural and horticultural societies and other organizations not operated for profit; * * * Provided, however, That this exception shall apply only to companies, organizations, corporations and/or societies named in this subsection which are not organized for profit, and no part of the income of which inures to the benefit of any stockholder or other private individual.'" (Underscoring added.)

The Court further said:

"The evidence discloses that appellee acts as a commissioned agent for shippers at the stockyards located in Evansville, buying and selling livestock, charging tariffs filed with the Secretary of Agriculture and in competition with others engaged in the same business. The bulk of its business consists of commissions on sales but in 1934 7.5% and in 1935 8.4% of its total volume consisted of carload purchases wherein it took title. Sometimes it purchases stock at the Evansville stockyards and holds same 'to sustain the price' and sometimes purchases in western markets for sale to persons from whom it has orders in less than carload lots. The profit, if any, derived from such sales is added to the funds realized from direct commissions. Any other income is added to get its gross income from which its expenses are deducted, leaving a net sum available for refunds. It reserves some part thereof as capital with which to do business. If a refund, which it calls a patronage dividend, is paid it goes to the persons who shipped to it in the year when the surplus was accumulated. Every person, firm or corporation not a member of a farm organization shipping stock to appellee is charged a $5 annual membership fee, retained out of his or its pro rata share of the refund, which fee is paid to the Farm Bureau organized in the county of his or its residence. Patronage dividends when paid are based on the ratio of the member's volume of business to the total volume of appellee's business for the same period.

* * * * * *

"The items of $2,008.59 in the year 1934 and $1,981.96 in the year 1935 were explained as the profit realized on its purchases and sales of livestock to which it took title but it was further explained that the figures do not represent a true profit because of items of expense impossible to allocate to specific transactions and therefore included generally in expenses. It may be assumed that the item of $459.59 in the year 1933 represents a loss instead of profit on similar operations. It is conceded that appellee's intent is to charge its patrons, for whom it buys, the actual cost of the livestock purchased for them so as not to make a profit for itself on the transaction. In the twelve years of its existence to 1935 it had suffered a net loss of $2,299.85 on such operations. It is apparent that the bulk of a member's refund, or dividend, represents a return of a pro rata portion of the commissions (denominated 'deductions' in the operating statement) earned by appellee but it is also true that some part of such dividend may represent the member's aliquot share of the profit realized by appellee on transactions where stock is purchased by it for resale. There is no contention that appellee engages in any other activity than those mentioned.

"To be within the exception appellee must be both an agricultural organization and one not operated for profit no part of whose income inures to the benefit of any private individual.

"While it is doubtful if appellee is an 'agricultural' organization within the meaning of the Gross Income Tax Act and likewise doubtful whether it is 'not operated for profit,' we deem it unnecessary to discuss either of those points because it is clear that some part of its income inures to the benefit of private individuals and for that reason, regardless of the others, appellee is not within the exception in the statute above quoted.

"Its principal argument to the contrary is based upon a clause in the Kentucky Act, Ky. St. § 883f-2, under which it was incorporated, which clause is found also in the Indiana 'Co-operative Marketing Act' (Acts 1925, c. 20, pp. 42, 43, § 2) reading: 'Associations organized hereunder shall be deemed "non-profit," inasmuch as they are not organized to make profit for themselves, as such, or for their members as such, but only for their members as producers.'

"Instead of supporting appellee's contention we think this clause indicates that the purpose of the organization is to make profit, not indeed for the corporation, but for persons shipping their products to the corporation. It is disclosed by the operating statement that in fact appellee does make a profit for those persons which accrues and is distributable in the form of 'patronage dividends' or, as denominated in the operating statement, 'refunds on deductions.' 'Members as producers' certainly are private individuals. Farmers shipping livestock raised on their farms do not cease to be private individuals when appellee pays to them sums which would have been profit to appellee if it had not been obliged to pass it on to the farmers with and for whom it did business.

"Appellee's argument further ignores the fact that the word 'income,' not 'profit,' is used in the phrase of the statute under consideration. Assuming that the corporation does not make a profit because it has no right to do so under its charter, nevertheless it has income, meaning receipts, as used in the Gross Income Tax Act and a very substantial part of that income (more than a third in 1935) inures, and is set up on its books, to the benefit of the producers with whom it does business.

"When a shipper pays appellee a commission for selling livestock the amount so paid belongs to appellee. If it costs appellee more than that commission to make the sale, there is no obligation on the part of the shipper to make up the difference. If it costs less appellee may use the excess for any purpose in connection with its business, including making good the loss on some other shipment. All commissions received by appellee become a part of its gross income. If at the end of the year its expenses have been less than the total of its income, the surplus still belongs to appellee, may be reserved as working capital and such reserve may be lost in whole or in part in a succeeding bad year. Or such surplus may be distributed as soon as the accountants have finished allocation. Appellee may have lost money on every one of numerous shipments by one producer but if on the whole it has had a successful year, he gets the same

dividend that any other shipper receives who has furnished an equal volume of business. While the dividend is not based on a share interest in the corporation, it is no less a dividend, not a return of an unused portion of a commission. We are satisfied that there is no reasonable hypothesis for holding that appellee does not have income inuring to the benefit of its patrons." (Underscoring added.)

It should be noted that the Court specifically held that the association had income. This would seem to be obviously correct with respect to the transactions involving the purchase of animals by the association that were sold by the association at a profit and on account of which no patronage refunds were made.

Now what is income? In United States v. Safety Car Heating & Lighting Company, 297 U.S. 88, the Supreme Court of the United States said:

"Income within the meaning of the Sixteenth Amendment is the fruit that is born of capital, not the potency of fruition. With few exceptions, if any, it is 'income' as the word is known in the common speech of men." (Underscoring added.)

The Court in the case under discussion specifically held that the patronage refunds paid on a patronage basis were a dividend and not a return of an unused portion of commissions paid by members. By a divident the Court meant a disbursement of money that is like the dividend paid by any corporation on its capital stock. It will be remembered that dividends may be paid, although they are not paid on a stock basis. In Paramount-Richards Theaters v. Commissioner of Internal Revenue, 153 F. 2d 602, it was said:

"Corporate earnings may constitute a dividend notwithstanding that the formalities of a dividend declaration are not observed; that the distribution is not recorded on the corporate books as such; that it is not in proportion to stockholdings, or even that some of the stockholders do not participate in its benefits. Nothing in the statute or decisions warrants the view that a dividend distribution loses its character as such and becomes a deductible business expense merely because stockholders do not benefit equally from the distribution. Regensburg v. Commissioner, 2 Cir., 144 F. 2d 41; Chattanooga Savings Bank v. Brewer, 6 Cir., 17 F. 2d 79; Christopher v. Burnet, 60 App. D.C. 365, 55 F. 2d 527; Hadley v. Commissioner, 59 App. D.C. 139, 36 F. 2d 543; Phelps v. Commissioner, 7 Cir., 54 F. 2d 289." (Underscoring added.)

Attention is called to the fact that the fundamental question the Court passed upon was whether the cooperative came within the exemption from the gross income tax of Indiana. One of the requirements for exemption was that "no part of the income of which inures to the benefit of any stockholder or other private individual," and the holding of the Court was that, "We are satisfied that there is no reasonable hypothesis for holding that appellee does not have income inuring to the benefit of its patrons."

INDICTMENT DISMISSED AGAINST COOPERATIVE AND OTHERS

On March 8, 1948, the Maryland & Virginia Milk Producers Association, Inc., was indicted in the District Court of the United States for the District of Columbia for an alleged violation of the Sherman Act (Title 15 U.S.C., Sec. 3), together with Chestnut Farms-Chevy Chase Dairy Company; Thompson's Dairy, Inc.; Richfield Dairy Corporation; Simpson Bros., Inc.; Safeway Stores, Inc.; Alexandria Dairy Products Company, Inc.; Harvey Dairy, Inc.; and B. B. Derrick.

The indictment, consisting of 39 paragraphs, is divided into six parts. Part IV is headed "THE CONSPIRACY," and all of the paragraphs appearing under this heading are set forth below:

"35. Beginning about the year 1930, the exact date being unknown to the Grand Jurors, and continuing thereafter up to and including the date of the return of this Indictment, the defendants have knowingly and continuously engaged in a wrongful and unlawful conspiracy to eliminate and suppress competition in the sale of milk to and the purchase of milk by defendant distributors, and in the sale of fluid milk and cream and milk products by the defendant distributors to consumers and other purchasers in the Washington metropolitan area, which combination and conspiracy has been and now is in restraint of trade and commerce in milk and milk products within the District of Columbia and between the District of Columbia and States of the United States, all in violation of Section 3 of the Act of Congress of July 2, 1890, entitled 'An Act to Protect Trade and Commerce Against Unlawful Restraints and Monopolies' commonly called the Sherman Act (Title 15, U.S.C., Sec. 3).

"36. The aforesaid conspiracy has consisted of a continuing agreement and concert of action among the defendants, the substantial terms of which has been:

"(a) That the defendant distributors enter into written and verbal contracts and agreements with the defendant Association to purchase their entire requirement of milk from defendant Association, to the extent that said defendant Association is able to supply said requirements, and to cease and refrain from the purchase of milk from producers who are not members of the defendant Association, and from other sources.

"(b) That the Association enter into written and verbal contracts and agreements with the defendant distributors to supply said defendant distributors with their full requirements of milk to the extent that the Association can do so.

"(c) That the defendant Association charge to each of said defendant distributors for milk delivered in the District of Columbia the same price for milk of equal grade and class as it is charged to each of the other defendant distributors receiving milk in the District of Columbia.

"(d) That the defendants agree that the Association refuse to supply milk to any distributor in the District of Columbia or the Washington metropolitan area who has not agreed to purchase his full requirements of milk from said Association, at prices as low as the prices charged by the Association to defendant distributors.

"(e) That the defendants agree upon a classification of milk in three classes having no relationship to purity or quality, said classification to be governed and determined by the use to which milk is put by each of the defendant distributors.

"(f) That the defendants agree that milk which is resold by defendant distributors in the form of fluid milk, shall be designated as Class I milk; that milk which is used by defendant distributors in cottage cheese, pot cheese, and baker's cheese, or which is separated by defendant distributors into cream and skimmed milk, the cream from which is sold by said defendant distributors in the form of fluid cream, shall be Class II milk; and that milk which is processed into manufactured milk products or which is separated into cream and skimmed milk, the cream from which is processed into a form other than fluid cream or sold for manufacturing purposes, shall be class III milk.

"(g) That defendants agree upon the price, or upon a formula which shall be applied in the calculation of the price paid by defendant distributors to defendant Association for each class of milk, and that the price paid for Class I milk be higher than the price paid for Class II milk, and that the price for Class II milk shall be higher than the price paid for Class III milk.

"(h) That the defendants agree that the defendant distributors shall not resell as fluid milk to consumers or other purchasers any milk which is purchased by them from the defendant Association at a price below the Class I price agreed upon among the defendants.

"(i) That the Association persuade and induce the Health Department of the District of Columbia, under the guise of health regulations, to prevent the importation of milk into the District of Columbia from sources outside of the States of Maryland and Virginia and from producers who have not been inspected and licensed by the District health authorities.

"(j) That the defendants agree among themselves to abandon and to cause to be terminated a milk marketing order of the United States Department of Agriculture affecting milk prices in the Washington metropolitan area (Order No. 45, as amended, regulating the handling of milk in the Washington, D. C., marketing area) following determination by said defendants

that the effect of said Order, if continued, would result in a reduction in the price to be paid by distributors for milk, and in the price to be charged for fluid milk and cream to consumers and other purchasers in the District of Columbia and the metropolitan Washington area.

"(k) That the defendants agree to persuade and induce the Virginia State Milk Marketing Commission to promulgate orders fixing minimum prices applicable to the purchase of milk and to the sale of fluid milk and cream by distributors in Arlington County and in Alexandria, Virginia, which said orders would eliminate provisions appearing in previous orders of the Virginia State Milk Marketing Commission, and in the terminated order of the United States Department of Agriculture, providing for a seasonal reduction in the minimum prices to be paid to producers for milk in the spring months of the year, and providing for a further decrease in the minimum prices for milk to be paid to producers in the event of a decline in the wholesale price of butter below a certain figure.

"(l) That the defendants agree to adopt and apply to purchases of milk for re-sale as fluid milk and cream in the District of Columbia and in Montgomery and Prince Georges Counties, Maryland, the minimum prices, classifications, and terms and conditions so established and promulgated by the Virginia State Milk Marketing Commission for application in Arlington County and Alexandria, Virginia.

"(m) That the defendants discuss and agree upon the prices at which the defendant distributors shall sell fluid milk and cream to consumers and other purchasers in the District of Columbia and in the Washington metropolitan area.

"(n) That the defendants agree that whenever the amount of milk available for sale by the defendant Association exceeds the amount of milk which the defendant distributors can resell as fluid milk and cream at the prices fixed and agreed upon, the defendants will remove this so-called 'excess milk' from the market by converting said milk into products other than fluid milk and cream.

"(o) That the defendants agree that the defendant distributors will remove from the market the 'excess milk' as alleged in sub-paragraph (n) of this paragraph, even though said defendant distributors may be required thereby to suffer a financial loss on the handling of the so-called 'excess milk.'

"(p) That the defendants agree that the Association will prevent and eliminate competition in the sale of fluid milk and cream from distributors who do not have full supply contracts with the Association, and eliminate and suppress price competition in the sale of fluid milk and cream by distributors, by inducing and persuading distributors not to cut prices; by

attempting to deprive non-contracting price-cutting distributors of an adequate supply of milk; by supplying milk to defendant distributors at prices below Class I prices for use by said defendant distributors to take away contract business from the price-cutting non-contracting distributors; by interfering with the ability of producers to transport milk to price-cutting non-contracting distributors; by forcing price-cutting non-contracting distributors out of business or into bankruptcy; and by other means.

"37. For the purpose of forming and effectuating the aforesaid conspiracy, the defendants by agreement and concerted action have done the things which, as hereinbefore alleged, they conspired to do."

On April 27, 1948, the case was dismissed. In dismissing the case, Judge Keech said:

"The Motion to Dismiss is in two parts: one, that it is duplicitous and the other that the indictment is bad in substance.

"The court holds that the indictment is not duplicitous.

"As to the second ground, namely, that this indictment does not charge a crime, the court grants the Motion to Dismiss, believing that there has been a failure to set forth sufficient facts.

"In doing this, I am not holding that the Sherman Act would not under any circumstances be applicable to a case involving cooperatives. I recognize and subscribe - as I must - to the determination in the Borden case, which holds that cooperatives are not exempt from the Sherman Act. I merely hold that the indictment in this case does not set forth sufficient facts to constitute a conspiracy in violation of Section III [sic] of the Sherman Act, in the view that I take of that act and other acts referred to in argument and judicial precedents presented."

ARE REFUNDS OF EXPENDITURES INCOME?

In Bartlett v. Delaney, 75 F. Supp. 490, the following appears:

"When a taxpayer receives in a second year a refund of an expenditure made in a previous year that refund is a return of capital unless he has retained some advantage from the initial expenditure. This is true whether the refund be a return of interest paid, taxes paid, or the purchase price of goods returned. So long as no advantage is retained as a result of the initial transaction the refund is from an economic and from a tax viewpoint a return of capital, not 'gross income.' It is not taxable under the Sixteenth Amendment. It is not within the asserted reach of § 42 or any other section of the Revenue Act of 1938. But since, when he filed his 1943 tax return, the taxpayer, exercising the option given him by

§ 23 (b), had claimed a deduction of $809.96 in his 1942 return, and no change had been made by anyone in that return, he was not entitled at the time he made the original 1943 return to omit the refund of $809.96. He had retained an advantage from the original expenditure. Therefore, the refund constituted gross income taxable under the Sixteenth Amendment and under the revenue laws. Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 298, 67 S.Ct. 271." (Underscoring added.)

SALE OF ALL COOPERATIVE ASSETS BY UNANIMOUS CONSENT

In the case of Autauga Co-operative Leasing Association v. Ward, decided by the Supreme Court of Alabama, 33 So. 2d 904, it appeared that the cooperative leased land from W. A. Gunter and Julia S. Gunter, with an option to purchase. The association at a meeting of all the members authorized an assignment and transfer of the lease with the option to purchase, and in pursuance of this authorization the lease was assigned to William Ward, who apparently attempted to exercise the option to purchase and then brought suit for the purpose of compelling a transfer of the land involved.

After the assignment of the lease with the option to purchase to William Ward, the association entered into an agreement with W. A. Gunter and Julia S. Gunter with a view to abrogating the assignment made to William Ward. William Ward prevailed in the trial court, and the association appealed. The Appellate Court stated that the chief question for consideration was "whether the assignment of the lease to complainant was valid and passed to him the right to exercise the option to purchase." It was argued that the assignment of the lease was invalid in that it amounted to the sale of the entire property of a private corporation without a compliance with section 91, Title 10, Code of 1940. The statutory provision in question reads as follows:

> "The entire property of a private corporation may be sold, exchanged, or bartered for other property, or otherwise disposed of when authorized by a vote of two-thirds of the board of directors and subsequently ratified by a vote of the holders of four-fifths in value of the capital stock of such corporation at a stockholders meeting called to consider the matter. Ten days' notice of such stockholders meeting shall be given in writing prior thereto and the purpose for which the meeting is called shall be stated in the notice."

The association is a nonstock association which issued no stock and which was not authorized to issue any stock. In holding that the statutory provision quoted above had no application to the cooperative association and that it did not in any way adversely affect the assignment of the lease with the option to purchase, the Court said:

> "The statute had its origin in an Act of April 21, 1911, Acts 1911, page 564. Prior to the enactment of it, corporations in the sale of their entire property were controlled by three principles.

(1) If it is a solvent going concern, it could not sell all its property without the unanimous consent of all its stockholders; but could do so by such consent. Elyton Land Co. v. Dowdell, 113 Ala. 177, 20 So. 981, 59 Am. St. Rep. 105; Morris v. Elyton Land Co., 125 Ala. 263, 28 So. 513; Tillis v. Brown, 154 Ala. 403, 45 So. 589. (2) If it was insolvent or in failing condition, the directors or a majority of its stockholders could sell all its property without any special procedure. 13 Am. Jr. 923, note 16; Oskaloosa Savings Bank v. Mahaska County State Bank, 205 Iowa 1351, 219 N.W. 530, 60 A.L.R. 1204; note 5 A.L.R. 932. (3) If it was a trading corporation, the directors could authorize such a sale without all the stockholders agreeing. Maben v. Gulf Coal & Coke Co., 173 Ala. 259, 55 So. 607, 35 L.R.A., N.S., 396.

"The statute certainly had as the main purpose a loosening up of the restrictions requiring all the stockholders to agree to a sale of all the property of a going concern. Forsyth v. Alabama City, C. & A. R. Co., 207 Ala. 488, 93 So. 401. Whether it makes the procedure a requirement in respect to a corporation which is insolvent or one of a trading sort, so that the directors must pursue that course if they are proposing to sell all its property without the consent of all the stockholders, is not here material. While this appellant, by virtue of section 7046, Code of 1923 and section 168, Title 10, Code of 1940, may be similar in some respects to the one treated in the Maben case, supra, we are clear that it was not intended in respect to any corporation to restrict the power to sell by the unanimous consent of all its stockholders, or those interested in it, conveying all its property.

"The restrictions of section 91, Title 10, supra, are to be construed on similar principles to section 70 (3), Title 10, Code, in respect to mortgaging the real property of a corporation. Both provisions are operative in their respective field. Boger v. Jones Cotton Co., 234 Ala. 103, 173 So. 495. It was held in Hillcrest Land Co. v. Foshee, 189 Ala. 217, 66 So. 478, that the provisions of section 70, supra, do not prevent all the stockholders from authorizing a mortgage by a procedure different from that provided for in that statute. The property of a corporation is in equity treated as owned by the stockholders, and they can do what they please with it by unanimous act, so long as the rights of others than the corporation are not infringed. First National Bank of Gadsden v. Winchester, 119 Ala. 168, 24 So. 351, 72 Am. St. Rep. 904; 12 Am. Jur. 1113, section 1215.

"We do not think that section 91, Title 10, supra, applies to a nonprofit corporation without capital stock, organized under section 168, Title 10, supra; but, even so, we think, as we have said, that any corporation can sell all of its property by the unanimous consent of all of those who belong to the organization.

"The resolution adopted by the members recites that it was by unanimous consent. Section 91, Title 10, supra, is for the benefit of stockholders, and it is only they who may claim benefits on

account of its nonobservance, not the corporation itself, nor one who stands in its rights. Boger v. Jones Cotton Co., 234 Ala. 103, 173 So. 495; Stuart v. Holt, 198 Ala. 73, 73 So. 390; Hillcrest Land Co. v. Foshee, 189 Ala. 217, 66 So. 478, 479; West Point Mining & Mfg. Co. v. Allen, 143 Ala. 547, 39 So. 351, 111 Am. St. Rep. 60, 5 Ann. Cas. 532; Nelson v. Hubbard, 96 Ala. 238, 11 So. 428, 17 L.R.A. 375. 'If they acquiesce, others (the corporation) cannot complain.' West Point Mining & Mfg. Co. v. Allen, supra [143 Ala. 547, 39 So. 352]; Nelson v. Hubbard, supra. Having once acquiesced, they are estopped to claim to the contrary. Hoene v. Pollak, 118 Ala. 617, 24 So. 349, 72 Am. St. Rep. 189." (Underscoring added.)

Attention is called to the fact that the Court expressed the view that the statutory provision relative to the sale of the property of a stock corporation had no application to a corporation without capital stock. The Court undoubtedly had in mind that the statutory provision on its face referred only to corporations formed with capital stock, and therefore it would seem to have no application to corporations formed without capital stock. The Court, however, rested its decision on the ground that any corporation "can sell all of its property by the unanimous consent of all those who belong to the organization," so long as the rights of third persons are not infringed.

BYLAW RESTRICTED TRANSFER OF STOCK

In the case of Evans v. Dennis, decided by the Supreme Court of Georgia, 46 S.E. 2d 122, it appeared that the McDuffie Progress Publishing Company, a corporation, "had a bylaw prohibiting the sale of stock by any stockholder unless it is first offered to other stockholders at par value plus 10 per cent." A stockholder of that corporation attempted to sell his stock without first offering it for sale to the petitioner. The petitioner made a tender pursuant to the terms and conditions of the bylaws of the corporation to the effect that he was ready and willing to purchase the stock under such terms. In the trial court, a demurrer to the petition of the petitioner was sustained and an appeal was then taken. In reversing the judgment of the trial court holding the bylaw in question invalid, the Appellate Court said:

> "The next question for determination is whether or not the petition states a cause of action against the defendant Dennis. The petition charges Dennis and named defendants with a conspiracy to buy and sell the stock of the corporation in violation of an alleged by-law prohibiting the sale of stock to an outsider until after such stock has been offered to the other stockholders at par value plus 10 per-cent. The defendant contends that such a by-law, if in existence during the time of the acts complained of, is invalid, being against public policy and in restraint of trade.
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> "The Code (Ann. Supp.), § 22-1827 (f), provides: 'Every corporation, by virtue of its existence as such, shall have power: * * * (f) To make by-laws not inconsistent with the Constitution or laws of the United States or of this State or of its charter for the exercise of

its corporate powers, the management, regulation and government of its affairs and property, the transfer of its stock, and the calling and holding of meetings of its stockholders and directors.'

"From the allegations of the petition in this case, it does not appear that the by-law in question is against public policy. A by-law of a corporation requiring a stockholder to offer his stock to other stockholders at a stipulated consideration before selling such stock to third persons, is not any more against public policy than a contract of like character between individuals. In Cothran v. Witham, 123 Ga. 190, 51 S.E. 285, 286, this court sustained an agreement by Cothran not to sell certain stock until after it had been offered to Witham in writing at the book value of the stock. In the opinion in the Cothran case this court held in part as follows: 'Counsel for the plaintiff in error also argued that the contract was against the policy of the law, in that it placed an indefinite restriction upon the alienation of the stock, and violated "the rule against perpetuities." We cannot concede the soundness of this argument, as we think it clear that the right of Cothran to sell the stock at any time he might see fit was not restricted, save that, before selling it to one other than Witham, he was bound to offer it to the latter, in writing, at its book value, and that, in any event, the contract would have terminated upon the death of Witham.' Compare Rhodes v. Lane, Ga. Sup. 44 S.E. 2d 114. (Underscoring added.)

"The rule laid down in the Cothran case is in accord with the general rule that a by-law of a corporation such as is alleged in the present case is valid and binding. In 13 Am. Jur. p. 413, § 338, the rule is stated as follows: 'Whether a by-law requiring a stockholder before selling his stock to afford the corporation or other stockholders an opportunity to purchase the same is valid, is the subject of conflicting decisions. According to the weight of authority, such as by-law is valid and binding upon the stockholder, either as a regulation within the powers of the corporation or a contract obligation voluntarily undertaken by the stockholder. [Italics ours.] The contrary view has, however, also been taken.'

"The petition in this case states a cause of action which entitles the petitioner to the opportunity of proving his allegations, and the court erred in sustaining the general demurrer filed by the defendant Dennis."